

Internal Revenue Service
memorandum

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TS/JIROSENBERG/alb

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to: District Counsel, Washington, D.C. MA:WAS
Attn: Diane Helfgott

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: [REDACTED]

TL-N-8746-90
CC:TL:TS Rosenberg Wilson
I.R.C. § 6231(c); Temp. Treas. Reg. § 301.6231(c)-7T(a)

This memorandum is response to your request for tax litigation advice dated July 11, 1990.

ISSUE

Whether the filing of bankruptcy petitions by shareholders of a subchapter S corporation results in the conversion of either or both shareholders' subchapter S items to nonsubchapter S items pursuant to Temp. Treas. Reg. § 301.6231(c)-7T(a).

CONCLUSION

Since at the time both bankruptcy petitions were filed, the United States could file a claim against each of the debtor shareholders for [REDACTED] the subchapter S items of both shareholders for [REDACTED] converted to nonsubchapter S corporation items pursuant to Temp. Treas. Reg. § 301.6231(c)-7T(a). Therefore, the shareholder in situation 1 could not have filed a petition for redetermination of subchapter S items, and a motion to dismiss for lack of jurisdiction must be filed. The same rationale applies to the shareholder in situation 2.

FACTS

Situation 1

On [REDACTED], the Service issued a notice of final subchapter S corporation administrative adjustment (FSAA) to the tax matters person of [REDACTED]

[REDACTED] for its [REDACTED] taxable year.

On [REDACTED] a notice shareholder of [REDACTED] filed a bankruptcy petition under chapter 7 of the Bankruptcy Code. A petition in Tax Court from the notice of FSAA

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was jointly filed on [REDACTED] (postmarked [REDACTED]) by two notice shareholders, one of whom was the shareholder in bankruptcy. The bankrupt shareholder received a discharge from the bankruptcy action on [REDACTED]

Situation 2

Same facts as Situation 1, except that a notice shareholder filed a bankruptcy petition under chapter 11 of the Bankruptcy Code in [REDACTED]. The plan was confirmed some time in [REDACTED]. The bankrupt shareholder is still a debtor in possession making payments under the plan, subject to the jurisdiction of the bankruptcy court. The plan has not been finally consummated and the bankruptcy is still open. This shareholder has filed a timely notice of election to participate in the Tax Court proceeding.

DISCUSSION

Section 6241 provides that except as otherwise provided in regulations prescribed by the Secretary, the tax treatment of any subchapter S item shall be determined at the corporate level. Section 6244 provides, in general, that the provisions of subchapter C of chapter 63 (I.R.C. §§ 6221-6233) which relate to partnership items are (except to the extent modified or made inapplicable in regulations) extended to and made applicable to subchapter S items. Sections 6221-6233 provide for the determination of the tax treatment of partnership items at the partnership level.

I.R.C. §§ 6244 and 6231(c)(2) permit the Secretary to determine special enforcement areas in which it is more appropriate to treat items as nonsubchapter items if treatment as a subchapter S item would interfere with the effective and efficient enforcement of the internal revenue laws. Temp. Treas. Reg. § 301.6231(c)-7T(a) states:

The treatment of items as partnership (subchapter S) items with respect to a partner (shareholder) named as a debtor in a bankruptcy proceeding will interfere with the effective and efficient enforcement of the internal revenue laws. Accordingly, partnership (subchapter S) items of such a partner (shareholder) arising in any partnership (S corporation) taxable year ending on or before the last day of the latest taxable year of the partner (shareholder) with respect to which the United States could file a claim for income tax due in the bankruptcy proceeding shall be treated as nonpartnership (nonsubchapter S) items as of the date the petition in bankruptcy is filed.

Under Temp. Treas. Reg. § 301.6231(c)-7T(a), the conversion occurs "as of the date the petition naming the [shareholder] as debtor is filed in bankruptcy.

In determining what items convert, it is necessary to determine the latest taxable year of the shareholder for which the United States could file a claim for income taxes due in the bankruptcy proceeding. Any items arising in that latest taxable year for which a claim could be filed, and items arising in prior years will convert to nonsubchapter S items. In addition, the conversion regulation provides that only partnership/subchapter S items which arise from a partnership/S corporation's taxable year which has ended on or before the latest year of the partner for which a claim could be filed will convert.

In the instant case, under the facts of Situation 1, at the time the bankruptcy petition was filed on [REDACTED], the United States could file a claim against the debtor shareholder for [REDACTED]. Therefore, the subchapter S items of that bankrupt shareholder for [REDACTED] converted as of [REDACTED], pursuant to Temp. Treas. Reg. § 301.6231(c)-7T(a).

A shareholder may not file a petition for readjustment an FSAA if his subchapter S items for the taxable year have become nonsubchapter S items. I.R.C. §§ 6244 and 6226(d)(2). Since the debtor shareholder's subchapter S items for taxable year [REDACTED] converted to nonsubchapter S items on the date of the filing of the bankruptcy petition, [REDACTED], that shareholder was not authorized to file the petition from the FSAA on [REDACTED]. Therefore, a motion to dismiss for lack of jurisdiction as to the bankrupt petitioning shareholder must be filed with the Court.

We note that under section 6229(f) the Service has one year from the date the subchapter S items converted to nonsubchapter S items to assess any tax attributable to those items. If the Service issued a notice of deficiency pursuant to section 6230(a)(2)(A) within one year of the date of conversion ([REDACTED]), then the suspension provision under section 6503(a)(1) would suspend the period of assessment while the Service is prohibited from assessing because of the bankruptcy proceeding. If the notice of deficiency was not timely issued, then the period of limitation on assessment of the converted items has expired.

In Situation 2, at the time the bankruptcy petition was filed in [REDACTED], the United States could file a claim against the debtor shareholder for income tax for taxable year [REDACTED]. Therefore, the subchapter S items of the bankrupt shareholder for [REDACTED] also converted as of the date of the filing of the bankruptcy petition pursuant to Temp. Treas. Reg. § 301.6231(c)-7T(a).

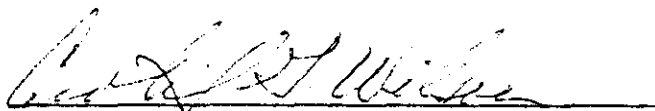
As in Situation 1, this shareholder's subchapter S items converted to nonsubchapter S items on the date of the filing of the bankruptcy petition. Due to the conversion of his subchapter S items, he has no interest in the outcome of the TEFRA proceeding. I.R.C. § 6226(d)(1)(A). As a result, the shareholder in Situation 2 is not a party to the TEFRA proceeding. I.R.C. § 6226(c). Therefore, since this shareholder has timely filed a notice of election to participate in the partnership proceeding and he is considered a party to the proceeding, a motion to dismiss for lack of jurisdiction is necessary.

Additionally, as in Situation 1, unless the Service issued a notice of deficiency pursuant to section 6230(a)(2)(A) within one year of the date of conversion, the period of limitations on assessment of the converted items has expired.

Should you have any further question regarding this matter, please contact Jeff Rosenberg at 566-3233.

MARLENE GROSS

By:


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